

Tagging Info**Fitch Upgrades \$228MM San Diego, California Tax-Supported Debt; Assigns \$153MM Initial Rating**Ratings
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Fitch Ratings-San Francisco-12 December 2008: Fitch Ratings upgrades its rating on San Diego, CA's \$8.6 million in outstanding general obligation (GO) bonds to 'A+' from 'BBB+' with a Stable Rating Outlook and removes the bonds from Rating Watch Positive. Also, Fitch upgrades various issues secured by lease payments made by the city to 'A' from 'BBB-' with a Stable Rating Outlook and removes these issues from Rating Watch Positive. Fitch also assigns an 'A' rating to a 2007 outstanding lease issue not previously rated by Fitch. The affected debt is detailed below and also outlined in Fitch's Rating Action Commentary dated Dec. 11 2008.

The ratings reflect the city's historically sound credit profile, with recent economic conditions causing significant financial strain. The upgrades reflect Fitch's recognition of the city's significant management structural and procedural changes, many implemented in response to the city's pension funding and disclosure turmoil and a widespread study commissioned by the city. Fitch downgraded the city's rating several times between February 2004 and May 2005 as details regarding the planned underfunding of the San Diego City Employees' Retirement System (SDCERS) became known. In May 2005 Fitch lowered the GO rating to 'BBB+' and all rated lease-secured obligations to 'BBB-' and placed all ratings on Rating Watch Negative in response to the uncertainty caused by the lack of audited financial statements, apparent internal control weaknesses, and awareness of significant growth in pension payments in the near future. In March 2008, following the city's release of audited financial statements for fiscal years 2003-2006 and with the financial stability exhibited in these reports and meaningful structural and operating changes implemented by city management, Fitch revised the Rating Watch to Positive. Since then the city released its fiscal 2007 audit and has provided preliminary data for fiscal 2008, confirming Fitch's expectation that the financial position would remain sound.

Going forward, the city's operations are pressured by weak performance by economically sensitive taxes because of the severe dislocation in the residential real estate market coupled with high pension payments, as the annual required contribution makes up for several years of underfunding. The city enters this period with good fund balance levels to buffer the impact, but significant budgetary action has been necessary already this fiscal year. San Diego's ability to close projected budget gaps given its high pension cost will be a key to retaining a sound credit profile. The ratings also consider the San Diego area's substantial housing market deterioration, with concerns as to the vulnerability to further declines and pace of any recovery.

San Diego's economy is marked by a diverse employment base with strong underpinnings in tourism, the military and related industries, and more recently, biotechnology. In recent years a construction boom, focused on housing and hotels, has fueled sizable assessed value and median home price gains. By the second quarter of 2006, the San Diego Metropolitan Area's (MSA's) median single family home price was more than triple that of the 1990s, rising to \$613,100. By the third quarter of 2008, however, the median sale price fell 38% to \$377,300. Figures for the city alone are not available, although reports indicate that the most severe losses are in the surrounding areas. Nonetheless, the city's tax base growth slowed to a still meaningful 6.5% for fiscal 2009, although a substantial number of assessment appeals have been filed which could reduce this figure. Fitch notes the MSA's relatively high share of negative amortization mortgages, almost double that of the U.S. average, which could be a contributing factor to the further residential market deterioration. In contrast, though, the area's exposure to subprime mortgages is about one-half that of the U.S. average.

Despite declines in construction and financial service jobs, the MSA's employment base rose in 2007, albeit at a slower pace than prior years. San Diego's unemployment rate remains below the state average, but beginning in 2008, monthly levels exceed that of the U.S. The city benefits from relatively high income levels, unusual for a central city with an above-average share of retirees.

The city's financial position is sound, marked by a good year-end balance. Annual operations have shown varied results, with strong tax performance yielding a sizable operating surplus in fiscal 2007 but a moderate operating deficit is expected based on unaudited results for fiscal 2008. The city expects to end fiscal 2008 with a general fund balance totaling \$109.6 million or a sound 9.8% of spending. The unreserved amount is estimated at \$73.7 million and will be just above the city's fund balance policy target of 6% of revenue. The fund balance policy gradually increases the minimum level to 8% of revenue in fiscal 2012.

The city acted quickly to adjust its fiscal 2009 budget in response to a 4% projected revenue shortfall stemming from a downward revision in property tax revenue and weak performance by economically sensitive taxes. Most of the action was taken in recurring expenditure savings, although about one-fourth is solved through non-permanent sources or revenue reallocations. The frequent budget monitoring that led to timely notice of the projected budget gap and effective action are evidence of good management practices. Fitch expects that the city will continue this diligent awareness and response in a timely fashion, next with the financial results for fiscal 2009's first half.

The city annually updates a five-year financial forecast, with the fiscal 2010-2014 report showing annual budget gaps ranging from 2%-6% of spending once adjustments are made for actions relating to the recent fiscal 2009 budget. The forecast is based on reasonable assumptions including slow property value growth. Nonetheless, Fitch believes the city's future financial efforts will be pressured by the continued economic drain from the housing market weakness as well as the sizable fixed cost represented by the annually required contribution to SDCERS and the potential for state funding cuts.

San Diego's debt burden is low and stable, with no exposure to variable rate obligations.

Fitch upgrades the following ratings, assigns a Rating Outlook Positive to each, and removes all from Rating Watch Positive:

San Diego

--\$8.6 million general obligation bonds, to 'A+' from 'BBB+';

--\$10.5 million certificates of participation (1993 Balboa Park/Mission Bay Park) series 2003 to 'A' from 'BBB-'.

San Diego Public Facilities Financing Authority

--\$22.8 million lease revenue bonds series 2002B to 'A' from 'BBB-';

--\$152.8 million ballpark lease revenue refunding bonds, series 2007A, a new rating of 'A'

San Diego/Metropolitan Transit Development Authority

--\$12.8 million lease revenue refunding bonds series 2003 to 'A' from 'BBB-'.

Convention Center Expansion Financing Authority

--\$173.4 million Lease revenue bonds series 1998A to 'A' from 'BBB-'.

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Fitch issued an exposure draft on July 31, 2008 proposing a recalibration of tax-supported and water/sewer revenue bond ratings, which, if adopted, may result in an upward revision of these ratings (see Fitch Research on "Exposure Draft: Reassessment of Municipal Ratings Framework"). Fitch has deferred its final determination on municipal recalibration due to market conditions and plans to revisit the recalibration in the first quarter of 2009 (see press release 'Fitch Defers Final Determination on U.S. Municipal Ratings Recalibration,' dated Oct. 7, 2008).

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